91-1677

(1)

No.

In the Supreme Court of the United States

OCTOBER TERM, 1991

COMMISSIONER OF INTERNAL REVENUE, PETITIONER

v.

KEYSTONE CONSOLIDATED INDUSTRIES, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

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QUESTION PRESENTED

Whether the contribution of property to a defined benefit pension plan by the plan's sponsoring employer, in satisfaction of the employer's funding obligation, constitutes a prohibited "sale or exchange" of the property under 26 U.S.C. 4975.

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KEYSTONE CONSOLIDATED INDUSTRIES, INC.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE FIFTH CIRCUIT

The Solicitor General, on behalf of the Commissioner of Internal Revenue, petitions for a writ of certiorari to review the judgment of the United States Court of Appeals for the Fifth Circuit in this case.

OPINIONS BELOW

The opinion of the court of appeals (App., *infra*, 1a-9a) is reported at 951 F.2d 76. The memorandum opinion of the United States Tax Court (App., *infra*, 10a-17a) is reported at 60 T.C.M. (CCH) 1423.

JURISDICTION

The judgment of the court of appeals was entered on January 17, 1992. The jurisdiction of this Court is invoked under 28 U.S.C. 1254(1).

STATUTES INVOLVED

Sections 404, 412, 4941, 4971, and 4975 of the Internal Revenue Code (26 U.S.C.) and Sections 302 and 406 of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1082 and 1106, are set forth in pertinent part in the appendix. App., *infra*, 45a-52a.

STATEMENT

1. During its taxable years ending June 30, 1983, through June 30, 1988, respondent Keystone Consolidated Industries, Inc., maintained several tax-qualified defined benefit pension plans.[1] The plans were subject to the funding requirements of Section 302 of the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. 1082. See also 26 U.S.C. 412. Respondent funded the pension plans through contributions to the Keystone Consolidated Master Pension Trust. App., *infra*, 2a.

On March 8, 1983, respondent contributed five truck terminals with a fair market value of $9,655,454 to the Pension Trust. Respondent credited the fair market value of the truck terminals against its statu-

[1] A defined benefit plan is a plan under which retirees receive a fixed amount per month, which is typically based on factors such as the retiree's prior salary and years of service. Such plans differ from defined contribution plans, under which employers typically contribute a percentage of their payroll or profits to a plan, which then allocates the contributions to individual accounts, and retirees are entitled to the amount in their individual accounts upon retirement. See 29 U.S.C. 1002(34) and (35). If a plan qualifies for favorable tax treatment, the employer may immediately deduct its contributions to the plan, but the plan participants are not taxed until they receive distributions from the plan. See 26 U.S.C. 402 (a)(1), 404(a)(1)(A).

tory funding obligations to its employees' defined benefit pension plans for its taxable years ending June 30, 1982, and June 30, 1983. App., *infra*, 11a. In addition, on March 13, 1984, respondent contributed to the Pension Trust real property in Key West, Florida, having a fair market value of $5,336,751. Respondent credited the fair market value of the Key West property against its statutory funding obligations to the Pension Trust for the taxable year ending June 30, 1984. *Id.* at 11a-12a.

Respondent claimed deductions on its federal income tax returns under 26 U.S.C. 404 in the amount of the fair market value of the five truck terminals and the Key West property. Respondent also reported the difference between its basis in those properties and the fair market values of the properties as capital gain, *i.e.*, as gain from the "sale or exchange" of capital assets. App., *infra*, 12a; see 26 U.S.C. 1222.

Section 4975 of the Internal Revenue Code imposes a two-tier excise tax on specified "prohibited transactions" between a pension plan and a "disqualified person," which includes the employer of the employees covered by the plan. 26 U.S.C. 4975(e)(2)(C).[2] Among the transactions prohibited by Section 4975 is the "direct or indirect * * * sale or exchange * * *

[2] The first tier of the excise tax is five percent of the "amount involved," 26 U.S.C. 4975(a), while the second tier is 100 percent of the "amount involved," 26 U.S.C. 4975(b). The "amount involved" is the greater of the fair market value of the property as given or received. 26 U.S.C. 4975(f)(4). Unlike the first tier tax, the second tier tax ordinarily may be avoided by timely correction of the prohibited transaction upon completion of the litigation concerning the taxpayer's liability for that tax. See 26 U.S.C. 4961(a), 4963(b) and (e), 6213(a), 7481(a). For example, in the case of a sale or exchange, the second tier tax may be avoided by correcting the transaction.

of any property between a plan and a disqualified person." 26 U.S.C. 4975(c)(1)(A). The Commissioner of Internal Revenue determined that respondent's transfers to the Pension Trust of the five truck terminals and the Key West property constituted "sale[s] or exchange[s]" of those properties within the meaning of Section 4975(c)(1)(A). Accordingly, the Commissioner determined that the transfers of the properties to the Pension Trust were prohibited transactions subject to excise tax under Section 4975.[3] Respondent filed a petition in the Tax Court for a redetermination of its liability for the excise taxes.

2. While respondent's case was pending before the Tax Court, the Tax Court rendered its decision in *Wood* v. *Commissioner*, 95 T.C. 364 (1990), rev'd, No. 91-1717 (4th Cir. Jan. 31, 1992); App., *infra*, 32a-44a, which presented the same issue as this case. In *Wood*, the taxpayer contributed three third-party promissory notes to his defined benefit pension plan in satisfaction of his statutory funding obligation.[4]

[3] The Commissioner determined deficiencies in respondent's first tier excise liability of $749,610 for its taxable year ending June 30, 1984, and of $482,773 for each of the taxable years ending June 30, 1983, and June 30, 1985, through June 30, 1988. The Commissioner also determined a deficiency in respondent's second tier excise tax liability for its taxable year ending June 30, 1988, in the amount of $9,655,454. App., *infra*, 12a.

[4] The taxpayer in *Wood* overstated the value of the notes, claiming a deduction for their face amounts, totaling $114,000, rather than for their fair market value of $94,430. 95 T.C. at 366. Although the taxpayer did not report any gain on the transfer of the notes to the plan, the parties stipulated in the Tax Court that the taxpayer was required to report the difference between the face amounts of the notes and the cost of the notes as capital gain, *i.e.*, as gain from the sale or exchange of a capital asset. 95 T.C. at 371-372.

In *Wood*, as in this case, the Commissioner determined that the transfer of property in satisfaction of the taxpayer's statutory funding obligation was a "sale or exchange" of the property within the meaning of Section 4975(c)(1)(A).

In *Wood*, the Tax Court rejected the Commissioner's position. The Tax Court acknowledged that the taxpayer's "transfer of the notes to the plan is a sale or exchange for purposes of recognition of income to him." App., *infra*, 42a. It further acknowledged that the case "demonstrate[d] potential for abuse" because the taxpayer "overstated the value of the property contributed to the plan." *Id.* at 38a. Furthermore, the Tax Court recognized that the Department of Labor, which has authority to interpret the prohibited transaction provisions—including Section 406 of ERISA, 29 U.S.C. 1106, which is parallel to Section 4975 and proscribes prohibited transactions between employee benefit plans and their fiduciaries—had concluded that a transfer of property to a defined benefit pension plan in satisfaction of an employer's funding obligation is a prohibited "sale or exchange" under Section 406(a)(1)(A). App., *infra*, 44a.

The Tax Court declined to give "sale or exchange" its usual meaning primarily because it concluded that the "detailed definition[] of sale or exchange" set out in Section 4975(f)(3) "should be applied in lieu of general definitions found in other areas of the tax law." App., *infra*, 42a. Section 4975(f)(3) provides that "[a] transfer [of] real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mort-

gage or similar lien." Thus, the Tax Court disagreed with the Commissioner's submission that Section 4975 (f)(3) expands the usual definition of "sale or exchange" to include all transfers of encumbered property to a plan, even those transfers that are entirely voluntary.[5] In short, the Commissioner had concluded that for purposes of Section 4975 "sale or exchange" includes not only transfers made to satisfy obligations, as is generally the case, but also any transfer of encumbered property, even if such a transfer would not normally constitute a "sale or exchange" with the plan. Contrary to the Commissioner's submission, the Tax Court held that Section 4975(f)(3) restricts the scope of "sale or exchange" for purposes of the prohibited transaction provision so that a transfer of unencumbered property to a pension plan in satisfaction of a funding obligation is not a "sale or exchange."

3. Shortly after the issuance of its opinion in *Wood*, the Tax Court issued a memorandum opinion in this case finding in favor of the taxpayer, essentially for the reasons stated in its prior decision. App., *infra*, 10a-17a.

[5] A voluntary transfer would include a transfer to a defined contribution plan that was not required by the terms of the plan. That is, many defined contribution plans provide that the sponsoring employer must contribute a certain amount to the plan, and further provide that the sponsor may make additional contributions. An additional contribution to a plan would not be a "sale or exchange" with the plan under the normal meaning of that phrase since it would not extinguish any obligation, and therefore such a contribution would not be prohibited by Section 4975(c)(1)(A). But if such a contribution consisted of encumbered property, it would be "treated as a sale or exchange," and hence be prohibited, under Section 4975(f)(3).

4. The Commissioner appealed the Tax Court's decisions in *Wood* and in this case to the Fourth Circuit and Fifth Circuit, respectively. In this case, the Fifth Circuit affirmed the decision of the Tax Court. The court of appeals reasoned that Section 4975(f)(3) "states that a transfer of property encumbered by a mortgage or lien *shall be treated* as a sale or exchange, implying that unless it is encumbered by a mortgage or lien, a transfer of property is not to be treated as if it were a sale or exchange." App., *infra*, 5a. With respect to the Commissioner's argument that Section 4975(f)(3) expands the definition of "sale or exchange" to include voluntary transfers of encumbered property, the court responded that, in its view, there is "no basis * * * anywhere in the Code" for distinguishing transfers of property in satisfaction of funding obligations from voluntary transfers of property to pension plans. App., *infra*, 6a.

The court of appeals added that, in its view, "[t]he potential for abuse, that is, satisfaction of minimum mandatory obligations with property with inflated values, would be the same regardless of whether the transfer was involuntary." App., *infra*, 6a. The court also stated that the potential for abuse in transfers of property in satisfaction of funding obligations is "already restrained" by the excise tax on accumulated funding deficiencies set out in 26 U.S.C. 4971. App., *infra*, 8a. Moreover, it is "irrelevant," the court stated, that transfers of property in satisfaction of obligations are treated as sales or exchanges of property for income tax purposes, because Section 4975 "was not enacted to measure economic income." App., *infra*, 7a. Finally, the court found that the contrary interpretations of the Department of Labor and of the Internal Revenue Service were entitled to no deference because those interpretations had been

set forth in advisory opinions and Revenue Rulings, respectively, and not in published regulations. *Id.* at 7a-8a.

5. In *Wood*, the Fourth Circuit "found itself in disagreement with the reasoning of the Fifth Circuit's decision in *Keystone Consol. Indus.*" App., *infra*, 28a. It instead gave "considerable weight" to the IRS's conclusion that "the transfer of property in satisfaction of a sponsor's statutory funding obligation" constitutes a "sale or exchange" of the property. *Id.* at 28a-29a. The Fourth Circuit also was "persuaded by the interpretation given to a parallel ERISA provision by the Department of Labor" in interpreting 29 U.S.C. 1106 to prohibit an employer from transferring "property in satisfaction of a sponsor's funding obligation." App., *infra*, 29a.

Contrary to the Fifth Circuit, the Fourth Circuit did "not view § 4975(f)(3) as a special rule limiting the applicability of the excise tax to contributions of encumbered property." App., *infra*, 27a. Rather, like the Commissioner, the Fourth Circuit concluded that Section 4975(f)(3) "reveals the intent of Congress to expand the definition of 'sale or exchange' as generally understood to include *all transfers* to a plan of *encumbered* property, whether or not in discharge of a debt, because transfers of encumbered property present a particularly significant potential for abuse." App., *infra*, 27a-28a; see also H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 308 (1974) (Section 4975(f)(3) "prevents circumvention of the prohibition on sale by mortgaging the property before transfer to the plan").[6] Thus, the Fourth Circuit held that, for purposes of the prohibited transaction provision, "sale or exchange" includes "the transfer of property in satisfaction of indebtedness," in line with the long-standing interpretation of that phrase. App., *infra*, 28a. "While the transfer to a plan of unencumbered property becomes a sale or exchange only if the transfer satisfies a funding obligation," the court continued, under Section 4975(f)(3) "when encumbered property is involved *all* transfers to the plan are prohibited, regardless of whether they are contributed in satisfaction of a pre-existing debt." App., *infra*, 29a-30a.

[6] With respect to the potential for abuse caused by transfers of unencumbered property to a pension plan in satisfaction of a debt, the Fourth Circuit in *Wood* noted that the prohibition against such transfers "is intended to avoid the potential for overvaluations of property to the detriment of the plan, precisely as occurred * * * when Wood purported to discharge a $114,000 obligation with third-party promissory notes having a value of only $94,430." App., *infra*, 25a.

REASONS FOR GRANTING THE PETITION

Section 4975(c)(1) of the Internal Revenue Code prohibits "any direct or indirect—(A) sale or exchange" between a plan and a disqualified person, such as respondent. The court of appeals' holding that respondent's transfer of property to the Pension Trust in satisfaction of its funding obligation was not a sale or exchange of the property is contrary to the language of the statute. In addition, the court's holding is in direct conflict with the decision of the Fourth Circuit in *Wood* v. *Commissioner*, No. 91-1717 (Jan. 31, 1992). The issue is of substantial administrative importance since many employers desire to transfer property to pension plans to satisfy their funding obligations, rather than paying their obligations in cash.

1. It is well established that the transfer of property in satisfaction of an obligation, as occurred in

this case when respondent transferred the truck terminals and the Key West property to the Pension Trust to satisfy its statutory funding obligations, generally constitutes a "sale or exchange" of the property. See, *e.g.*, *Helvering* v. *Hammel*, 311 U.S. 504 (1941); *Lakeside Irr. Co.* v. *Commissioner*, 128 F.2d 418, 419 (5th Cir.), cert. denied, 317 U.S. 666 (1942); *Burger-Phillips Co.* v. *Commissioner*, 126 F.2d 934, 935 (5th Cir. 1942); *Pender* v. *Commissioner*, 110 F.2d 477, 478 (4th Cir.), cert. denied, 310 U.S. 650 (1940); *Laport* v. *Commissioner*, 671 F.2d 1028, 1033 (7th Cir. 1982); *Stamler* v. *Commissioner*, 145 F.2d 37, 39 (3d Cir. 1944); *Larus* v. *Commissioner*, 123 F.2d 254, 255 (2d Cir. 1941). Similarly, the courts have treated transfers of property to satisfy a bequest that was stated in dollar terms, a transaction not unlike a transfer of property in satisfaction of a funding obligation, as a "sale or exchange" of the property transferred. See *Kenan* v. *Commissioner*, 114 F.2d 217, 219-220 (2d Cir. 1940); *Brinckerhoff* v. *Commissioner*, 8 T.C. 1045, 1049 (1947), aff'd, 168 F.2d 436 (2d Cir. 1948).

The administrative interpretations of the Department of Labor regarding the transfer of property to a plan in satisfaction of the employer's statutory minimum funding obligation are consistent with the many decisions holding that the transfer of property to satisfy an obligation is a "sale or exchange" of the property. Section 4975 originated in Title II of ERISA (which amended various provisions of the Internal Revenue Code relating to pension plans), and a parallel and identical (as relevant here) provision setting forth "prohibited transactions" was enacted in Title I of ERISA ("protection of employee

benefit rights"), which is administered by the Department of Labor. That provision, Section 406 of ERISA, 29 U.S.C. 1106, prohibits a fiduciary of a pension plan from engaging in a transaction that he knows or should know constitutes a direct or indirect "sale or exchange" of property between the plan and a party in interest. Congress stated that, "[t]o the maximum extent possible, the prohibited transaction rules are identical in the labor and tax provisions, so they will apply in the same manner to the same transaction." H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 295-296 (1974). Accordingly, the Department of Labor's interpretation of Section 406 of ERISA is instructive with respect to the proper interpretation of Section 4975 of the Internal Revenue Code.[7]

The Department of Labor has concluded that the transfer of property in satisfaction of a funding obligation is a "sale or exchange" under Section 406 of ERISA. In DOL Advisory Opinion 81-69A (July 28, 1981), the Department ruled that a sponsoring employer's contribution of unencumbered property to a pension plan was a prohibited sale or exchange. The ruling concluded that such a transaction "constitutes a discharge by the Employer of its legal obligation to make the contribution for that year. In effect, the Plan is exchanging its legal right to payment of the contribution for property other than cash." Accord DOL Advisory Opinion 90-05A (Mar. 29, 1990).

The IRS has accorded the same meaning to the phrase "sale or exchange" in interpreting Section

[7] In fact, the Department of Labor has primary authority to construe both 29 U.S.C. 1106 and 26 U.S.C. 4975. See Reorg. Plan No. 4 of 1978, § 102, 92 Stat. 3790.

4941 of the Internal Revenue Code, upon which Section 4975 was modeled. S. Rep. No. 383, 93d Cong., 1st Sess. 32 (1973); H.R. Conf. Rep. No. 1280, *supra*, at 306. Section 4941(d)(1)(A) defines the term "self-dealing" to include the "sale or exchange" of property between a private foundation and a disqualified person. If a transaction constitutes "self-dealing" under Section 4941, an excise tax is imposed, as under Section 4975, whether or not the particular transaction, in fact, met an "arm's-length" standard of dealing between the parties. In Rev. Rul. 81-40, 1981-1 C.B. 508, the Internal Revenue Service ruled that if a disqualified person attempted to correct an act of self-dealing (there, the borrowing of money from a private foundation) by transferring real estate to the private foundation in cancellation of the indebtedness, the transfer of the property in satisfaction of the indebtedness would constitute a second act of self-dealing, because the transfer of the property in satisfaction of the indebtedness would constitute a sale of property within the meaning of Section 4941. Accord, Rev. Rul. 77-379, 1977-2 C.B. 387; see Treas. Reg. 1.415-6(b)(4).

2. In *Wood* v. *Commissioner*, *supra*, the Fourth Circuit agreed with the Commissioner that the transfer of property in satisfaction of a funding obligation is a prohibited "sale or exchange" under Section 4975. Moreover, in that case the Fourth Circuit explicitly stated that it found itself "in disagreement with the reasoning of the Fifth Circuit's decision" in this case. App., *infra*, 28a. Thus, there is a square conflict on the question presented in this case.[8]

[8] The Fourth and Fifth Circuits also disagreed on a subsidiary issue, whether deference should be given to the opinions of the IRS and the Department of Labor. The Fourth Circuit stated that it was "persuaded" by the Department of Labor's interpretation of ERISA and added that it gave "considerable weight" to the IRS's views. App., *infra*, 28a-29a. In this case, in contrast, the court of appeals declined to accord any significance to the advisory opinions of the Department of Labor, noting that such opinions were binding only on the parties. *Id.* at 7a-8a. However, in a more recent case the Fifth Circuit stated that "DOL opinions 'constitute a body of experience and informed judgment to which courts and litigants may properly resort for guidance.'" *Md. Physicians & Associates, Inc.* v. *State Board of Insurance*, No. 91-1469 (5th Cir. Apr. 1, 1992), slip op. 3519 n.9, quoting *Skidmore* v. *Swift & Co.*, 323 U.S. 134, 140 (1944); see also *Massachusetts* v. *Morash*, 490 U.S. 107, 118 & n.14 (1989); *Fraver* v. *North Carolina Farm Bureau Mutual Insurance Co.*, 801 F.2d 675, 677-678 (4th Cir. 1986); *Shea* v. *Wells Fargo Armored Service Corp.*, 810 F.2d 372, 376 (2d Cir. 1987). In addition, the court of appeals concluded that the IRS's views were entitled to no deference because the Commissioner had not asserted the same arguments in prior litigation. App., *infra*, 8a. But the Commissioner's longstanding interpretation of the statutory language upon which Section 4975 was modeled was fixed, and has remained constant, since the promulgation of Rev. Rul. 77-379, *supra*, and Rev. Rul. 81-40, *supra*.

The Fourth Circuit reached the correct result. Section 4975(c)(1)(A) prohibits any direct or indirect sale or exchange between a plan and a sponsoring employer. A transfer of property in fulfillment of an obligation is plainly a sale or exchange with the plan. Such a transaction is no different, in substance, from one in which the sponsor of a plan makes a payment in cash and the plan simultaneously uses the funds to purchase the property from the sponsor. The transfer of property in satisfaction of an obligation simply collapses those two steps into a single transaction, but does not change its essential character as a sale or exchange of the property trans-

ferred. Cf. *Pender* v. *Commissioner*, 110 F.2d at 478; *Burger-Phillips Co.* v. *Commissioner*, 126 F.2d at 936; *Kenan* v. *Commissioner*, 114 F.2d at 219; *Commissioner* v. *S.A. Woods Mach. Co.*, 57 F.2d 635, 636 (1st Cir.), cert. denied, 287 U.S. 613 (1932); see also 2 B. Bittker, & L. Lokken *Federal Taxation of Income, Estates and Gifts*, para. 40.4, at 40-11 (1990); S. Surrey, P. McDaniel, H. Ault & S. Koppelman, *Federal Income Taxation* 928 (Successor ed. 1986). Thus, by transferring its truck terminals and the Key West property to the Pension Trust in satisfaction of its funding obligations, respondent accomplished precisely what Section 4975(c)(1)(A) explicitly prohibits—selling those properties to the Pension Trust.

Contrary to the view of the court of appeals in this case, the prior judicial decisions construing "sale or exchange" are not rendered "irrelevant" because they arose under the income tax provisions of the Internal Revenue Code. App., *infra*, 7a. To the contrary, the rationale of the decisions—that a transfer in fulfillment of an obligation is just a type of sale or exchange—is entirely applicable under Section 4975(c)(1)(A). Moreover, the phrase "sale or exchange" had acquired a settled judicial and administrative interpretation over the course of more than 50 years before Congress enacted even broader statutory language—embracing "*any* direct *or indirect* * * * sale or exchange"—in Section 4975. Congress was presumptively aware that the phrase "sale or exchange" embraced the transfer of property in satisfaction of an obligation when it enacted Section 4975. *Albernaz* v. *United States*, 450 U.S. 333, 341 (1981). Furthermore, the court of appeals, unlike the Fourth Circuit in *Wood*, declined to heed "[t]he normal rule of

statutory construction * * * that 'identical words used in different parts of the same act are intended to have the same meaning,'" *Sorenson* v. *Secretary of the Treasury*, 475 U.S. 851, 860 (1986); see also *Ardestani* v. *INS*, 112 S. Ct. 515, 519 & n.2 (1991), as well as this Court's admonition in *Commissioner* v. *Lester*, 366 U.S. 299, 304 (1961) that "the Code must be given 'as great an internal symmetry and consistency as its words permit.'"

In addition, the result reached by the court of appeals in this case undermines Congress's purpose in enacting the prohibited transaction provisions of ERISA. Through Section 406 of ERISA and Section 4975 of the Internal Revenue Code, Congress sought to prevent transactions that present a significant potential for the loss of plan assets or for insider abuse. See *Leib* v. *Commissioner*, 88 T.C. 1474, 1481 (1987); see also *McDougall* v. *Donovan*, 552 F. Supp. 1206, 1215 (N.D. Ill. 1982); *Freund* v. *Marshall & Ilsley Bank*, 485 F. Supp. 629, 636-637 (W.D. Wis. 1979). Prior to the enactment of Section 4975, the applicable prohibited transaction rules imposed an "arm's-length" standard of conduct. S. Rep. No. 383, 93d Cong., 1st Sess. 32 (1973). The arm's-length standard, however, "require[d] substantial enforcement efforts, resulting in sporadic and uncertain effectiveness of these provisions." *Ibid.* In specifying several discrete categories of transactions that would be prohibited, Congress intended to "substantially strengthen[]" the prohibited transaction rules. *Ibid.* Sales and exchanges of property between insiders and pension plans were designated as prohibited transactions to ensure both the integrity of pension plans and that insiders did not use plans for their own interests. By establishing a clear rule,

Congress sought to eliminate the possibility that sales or exchanges of property between insiders and pension plans might not be at arm's-length, or might otherwise not be in the best interest of the plan. As the Fifth Circuit explained in *Donovan* v. *Cunningham*, 716 F.2d 1455, 1464-1465 (1983), cert. denied, 467 U.S. 1251 (1984), the object of the prohibited transaction provisions "was to make illegal per se the types of transactions that experience had shown to entail a high potential for abuse." Accord *Leib* v. *Commissioner*, 88 T.C. at 1481.

Transfers of property in satisfaction of funding obligations, as occurred in this case and in *Wood*, carry the potential for insider abuse that Congress sought to inhibit by prohibiting both direct and indirect sales or exchanges. As we have shown, a sponsoring employer may, in effect, sell property to a pension plan by contributing it to the plan. Thus, the purpose of Section 4975(c)(1)(A)—to protect pension plans against insider dealings—would be easily thwarted if the very same insiders that Congress sought to preclude from selling property to a plan were permitted to do so by transferring property to the plan in satisfaction of a funding obligation.

3. The court of appeals interpreted "sale or exchange" in Section 4975(c)(1)(A) contrary to its ordinary, settled meaning primarily on account of its construction of Section 4975(f)(3), which provides that "[a] transfer [of] real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien." The court of appeals read Section 4975(f)(3) as "implying that unless [property] is encumbered by a mortgage or lien, a transfer of property is not to be treated as if it were a sale or exchange." App., *infra*, 5a. In *Wood*, the Fourth Circuit addressed that conclusion and stated that "[b]ecause we find that § 4975(f)(3) serves the special need of expanding the scope of prohibition when *encumbered* property is involved, we find ourselves in disagreement with the reasoning of the Fifth Circuit's decision in *Keystone Consol. Indus.*" App., *infra*, 28a.

The Fourth Circuit gave Section 4975(f)(3) its more natural reading. Section 4975(f) sets out "other definitions and special rules." Section 4975(f)(3) contains a special rule providing that a transfer of encumbered property "shall be treated as" a sale or exchange. That supports the Fourth Circuit's conclusion that Congress intended Section 4975(f)(3) to expand the scope of the prohibited transaction provision. Under Section 4975(f)(3), even a transfer that would not normally be considered to be a sale or exchange, such as a voluntary transfer of property to a defined contribution plan by the plan's sponsor would be "treated as" a sale or exchange if the property were encumbered. But a special rule treating such a transaction as a sale or exchange should not be interpreted to restrict the normal meaning of "sale or exchange" so that indirect sales or exchanges—and, presumably, even direct ones—are permissible so long as the property involved is not encumbered.[9]

[9] In *Wood*, the Fourth Circuit also properly rejected the taxpayer's argument that "the imposition of an excise tax on the contribution of property in satisfaction of indebtedness is inconsistent with 26 U.S.C. 404 of the Code, which permits plan sponsors to claim income tax deductions for their noncash contributions to employee benefit plans." App., *infra*, 30a. In some situations—*e.g.*, where a purely voluntary contribution is made to a defined contribution plan—there is no tension at all between the provisions since the transaction

The court of appeals said that it saw "no basis" for distinguishing purely voluntary transfers of property from other transactions. App., *infra*, 6a. But such a distinction is inherent in Congress's scheme. By broadly prohibiting "any direct or indirect * * * sale or exchange" in Section 4975(c)(1)(A), Congress was addressing all transactions that are, in some sense, exchanges—such as respondent's transfers of property to satisfy its funding obligations. By adding in Section 4975(f)(3) that a transfer of encumbered property "shall be treated" as a sale or exchange, Congress provided that some transfers that are not exchanges, but are entirely voluntary, are also prohibited if engaged in by disqualified persons. At the same time, a transfer of unencumbered property that is not made to discharge an obligation is not prohibited; there is little room for abuse in such a case since, no matter what the plan receives, it is necessarily better off than it was before the transfer.[10]

is not prohibited by Section 4975 and a deduction is allowed under Section 404(a)(3). And the prohibited transaction provision is not actually in tension with Section 404 even in the case of a prohibited transaction: as the Fourth Circuit explained, "[a]lthough the excise tax of § 4975 discourages the contribution of non-cash property in satisfaction of a sponsor's funding obligation, it does not preclude the deductibility of these contributions." App., *infra*, 30a. Furthermore, if there is thought to be tension in allowing a deduction for a prohibited transaction, the taxpayer's position does not eliminate that tension because under everyone's construction of Section 4975 transfers of encumbered property are prohibited, but the fair market value of the transferred property is deductible under Section 404.

[10] The court of appeals suggested that there was no need to distinguish transfers that discharge obligations from purely voluntary transfers because Section 4971 imposes a tax on plans that are underfunded. But while there is some overlap between the purposes of Sections 4971 and 4975 because prohibited transactions may lead to underfunding, underfunding was not Congress's primary interest in enacting Section 4975. A sale between an insider and a pension plan is prohibited whether or not it results in underfunding. Indeed, such a sale is prohibited by Section 4975(c)(1)(A) even if it is undisputed that the plan paid fair market value for the property. Section 4971, on the other hand, imposes a tax on accumulated funding deficiencies whether caused by plan losses, insider transactions, or otherwise.

Indeed, the construction given Section 4975 by the court of appeals in this case is contrary to common sense. The court properly read Section 4975(f)(3) as setting forth a protective rule providing that any contribution of encumbered property by a plan sponsor is prohibited, even if the transfer benefits the plan. At the same time, however, in light of its construction of Section 4975(f)(3), the court of appeals read Section 4975(c)(1)(A), contrary to the settled meaning of "sale or exchange," not to prohibit transactions such as occurred in *Wood*, where unencumbered property with a fair market value of $94,430 was transferred to a plan in satisfaction of a $114,000 funding obligation. Thus, the court of appeals construed the protection provided by Section 4975(f)(3) to undo the protection provided by Section 4975(c)(1)(A).

The court of appeals also read Section 4975(f)(3) out of its historical context. Section 4941, the statute after which Section 4975 was modeled, contains a provision, Section 4941(d)(2)(A), that is nearly identical to Section 4975(f)(3). Section 4941(d)(2)(A) provides, as a "special rule," that a transfer of encumbered property by a disqualified person to a private foundation "shall be treated as a sale or exchange," and therefore as "self-dealing." Contributions of property to private foundations, of course,

typically are *not* made in satisfaction of legal obligations. Hence, it is clear that the central function of Section 4941(d)(2)(A) is to prohibit *voluntary* transfers of encumbered property by disqualified persons to private foundations. It would make no sense at all to conclude that Section 4941(d)(2)(A) *excludes* from the scope of prohibited self-dealing a transfer of property to a private foundation in satisfaction of an indebtedness owed to the private foundation. Cf. Rev. Rul. 81-40, *supra*; Rev. Rul. 77-379, *supra*.

4. The decision of the court of appeals poses a serious threat to the ability of the Internal Revenue Service to carry out its congressional mandate to ensure that insiders do not use pension plans for self-dealing. The question presented is a recurring one that is of substantial administrative importance since it affects all employers who might transfer property to qualified pension plans to satisfy their funding obligations. The IRS estimates that, in 1989 alone, in-kind property with a total purported fair market value of more than $243 million was contributed by employers to more than 400 separate plans. In the IRS's view, many of those contributions were prohibited transactions. Resolution of the recurring question presented by this case is needed to avoid continuing uncertainty and to ensure even-handed application of the revenue laws.

CONCLUSION

The petition for a writ of certiorari should be granted.

Respectfully submitted.

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APRIL 1992

APPENDIX A

UNITED STATES COURT OF APPEALS
FIFTH CIRCUIT

No. 91-4208

KEYSTONE CONSOLIDATED INDUSTRIES, INC.,
PETITIONER-APPELLEE

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT-APPELLANT

Appeal from a decision of the United States
Tax Court

Jan. 17, 1992

Before JOLLY, JONES, and EMILIO M. GARZA, Circuit Judges.

E. GRADY JOLLY, Circuit Judge:

Keystone, the taxpayer, transferred property to its tax qualified defined benefit pension plan in satisfaction of its statutory minimum funding requirements.

The Commissioner asserted that this transfer of property in satisfaction of an obligation was a sale or exchange within the meaning of Section 4975(c)(1)(A), and therefore asserted tax deficiencies under Section 4975(a) and (b).

Keystone filed suit in the tax court, contending that it was not liable for the deficiencies. The tax court granted summary judgment in favor of Keystone, holding that neither the plain language of the statute nor the congressional intent in drafting it suggests that Section 4975 was meant to apply to the transfer of unencumbered property. We agree with the tax court's reasoning, and therefore affirm the tax court's order.

I

The relevant facts are undisputed. Keystone Consolidated Industries, Inc. ("Keystone") maintained several tax qualified defined benefit pension plans. The plans were subject to the minimum funding requirements of Section 302 of ERISA. 26 U.S.C. § 412. Keystone funded the plans through contributions to the Keystone Consolidated Master Pension Trust (the "Trust").

In 1983, Keystone contributed five truck terminals to the Trust. Keystone credited the fair market value of the terminals against its statutory minimum funding obligations for its taxable years ending on June 30, 1982 and June 30, 1983. In March of 1984, Keystone contributed real property to the Trust and credited the fair market value of this property against its statutory funding obligations for the tax year ending on June 30, 1984.

The terminals and the property were not subject to any mortgage at the time they were transferred

to the Trust. The terminals and the real property were not the subject of any leaseback agreements with Keystone.

Keystone claimed deductions in the amount of the fair market value of the terminals and the real property under Section 404 of the Internal Revenue Code. Keystone reported the difference between its cost to acquire those properties and their fair market value at the time of their transfer as capital gains from the sale or exchange of an asset under Section 1222.

The Tax Commissioner determined that Keystone's transfer of the truck terminals and real property to the Trust in satisfaction of its statutory funding requirements was a "sale or exchange" within the meaning of Section 4975(c)(1)(A) of the Code, and was therefore a prohibited transaction. Accordingly, the Commissioner asserted tax deficiencies under Section 4975(a) and (b).

II

Keystone filed a petition in the tax court contesting its liability for these deficiencies. The Commissioner argued that it is well established that a transfer of property in satisfaction of indebtedness is treated as a sale or exchange. The Commissioner also argued that the congressional intent behind the prohibited transactions provision is consistent with his view of a sale or exchange.

The tax court decided the case on cross-motions for summary judgment. The tax court held that the transfers were not sales or exchanges. The court held that a definition of the sale or exchange that involves the transfer of property is provided by Section 4975(f)(3), which states that a transfer of property encumbered by a mortgage or a lien, which the plan

assumes, shall be treated as a sale or exchange. The tax court noted that neither the terminals nor the real property was subject to a mortgage or lien, and therefore, held that the transfers were not sales or exchanges. The Commissioner now appeals.

III

On appeal, the Commissioner argues mainly that Section 4975(f)(3) is not the exclusive definition of a sale or exchange that involves the transfer of property. He argues that this definition applies only to voluntary transfers of property, i.e., transfers over and above minimum funding requirements, and that involuntary transfers of property, i.e., transfers to satisfy minimum funding requirements, are sales or exchanges irrespective of Section 4975(f)(3). Keystone argues that according to the plain language of the statute, only transfers of encumbered property are to be treated as sales or exchanges under Section 4975.

IV

Thus, we are presented with the question whether a taxpayer's contribution of property to a tax qualified defined benefit pension plan in satisfaction of its statutory funding requirements is a sale or exchange under Section 4975(c)(1)(A). Section 4975(c)(1)(A) defines a prohibited transaction as any direct or indirect "sale or exchange, or leasing, of any property between a plan and a disqualified person." Section 4975(a) imposes a tax on the disqualified person equal to five percent of the amount involved in the prohibited transaction. Section 4975(b) imposes an additional tax on the prohibited transaction equal to one hundred percent of the amount involved. This

tax may be avoided by correcting the transaction within the taxable period. Keystone is a disqualified person under Section 4975(e)(2)(C). The tax qualified defined benefit pension plan at issue is a plan covered by Section 4975. 26 U.S.C. § 4975(e)(1). Therefore, the only question we are required to decide is whether the contribution of property was a sale or exchange under Section 4975(c)(1)(A).

V

Keystone argues that in accordance with Section 4975(f)(3), only a transfer of property that is subject to a mortgage or lien is to be treated as a sale or exchange.[1] We agree with the taxpayer. If all transfers of property to a plan were to be treated as a sale or exchange, then this definition would be superfluous. The definition states that a transfer of property encumbered by a mortgage or lien *shall be treated* as a sale or exchange, implying that unless it is encumbered by a mortgage or lien, a transfer of property is not to be treated as if it were a sale or exchange.

The Commissioner argues that this definition of a sale or exchange that involves the transfer of property is not an exclusive definition; he argues that if

[1] Section 4975(f)(3) provides:

(f) Other definitions and special rules.—For purposes of this section—

(3) Sale or exchange; encumbered property.—A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transaction.

Congress had intended it to be, it would have said a sale or exchange includes *only* these transfers. The Commissioner argues that Section 4975(f)(3) is not superfluous because it applies to voluntary transfers. He argues that involuntary transfers of property, that is, transfers in satisfaction of a statutory obligation, are "exchanges," irrespective of Section 4975(f)(3).

We cannot accept the Commissioner's arguments. In the first place, there is no basis for this distinction between involuntary and voluntary transfers anywhere in the Code. Furthermore, this distinction also makes no economic sense. A contribution is involuntary because the contribution is required to satisfy the minimum funding requirement for that year. However, when an employer makes a voluntary contribution to a plan, he effectively supplements the assets of the plan, receives a credit in his funding standard account, and thereby reduces the amount of mandatory contributions in future years. 26 U.S.C. § 412. The potential for abuse, that is, satisfaction of minimum mandatory obligations to the pension fund with property with inflated values, would be the same regardless of whether the transfer was involuntary. Thus, there is neither statutory nor economic support for the Commissioner's argument.

The Commissioner argues further that the congressional intent behind the prohibited transaction provision supports his interpretation of "sale or exchange." We disagree. The Commissioner only points to one excerpt from a Senate Report that states that one of the principle purposes of Section 4975 was to prevent the possibility that a non-arm's length transaction might go undiscovered. The Commissioner offers no evidence that Congress intended Section 4975

(a)(1)(A) to apply to the transfer of unencumbered property. Accordingly, we reject the Commissioner's statutory construction of Section 4975(f)(3).

Next, he argues that it is well established that a transfer of property in satisfaction of a debt or a bequest is a sale or exchange. The fact that a transfer of property is treated as a sale or exchange for income tax purposes is not determinative of whether the same transaction is a sale or exchange under the prohibited transaction provision. The meaning of "sale or exchange" depends on the context and the particular statute at issue. *United States v. Davis*, 370 U.S. 65, 69 n. 6, 82 S.Ct. 1190, 1192 n. 6, 8 L.Ed.2d 335 (1962); *Helvering v. Hammel*, 311 U.S. 504, 507, 61 S.Ct. 368, 369-70, 85 L.Ed. 303 (1941). Section 4975 was not enacted to measure economic income; it was enacted to prohibit a specific list of self-dealing transactions between a plan and an employer. Therefore, the fact that the transfer of property in satisfaction of a debt or obligation is a sale or exchange for purposes of the income tax statutes is irrelevant to whether the same transfer is a sale or exchange prohibited by Section 4975.

The Commissioner argues next that the administrative views of the Commissioner, the IRS and the Department of Labor should be given deference. He argues that the IRS and the Department of Labor have found that similar transfers of property to pension funds were sales or exchanges under other sections of the Code and ERISA.[2] The Commissioner

[2] The IRS, in two revenue rulings, found that the transfer of property to a private foundation was a sale or exchange, making the transfer an act of self-dealing subject to a tax under Section 4941. Rev.Rul. 81-40, 1981-1 C.B. 508; Rev. Rul. 77-379, 1977-2 C.B. 387. The DOL, in an advisory opin-

has never promulgated any regulation declaring a transfer of property to be a sale or exchange. In fact, the Commissioner asserted his argument for the first and only time prior to this case in *Wood v. Comm'r*, 95 T.C. 364 (1990), and the Tax Court rejected it. Under these circumstances, the Commissioner's views are not entitled to any deference. The Department of Labor's advisory opinion is binding only on the parties thereto, and has no precedential effect. ERISA Proc. 76-1, § 10. The revenue rulings deal with Section 4941, which, although similar to Section 4975, contains no definition of a sale or exchange as found in Section 4975(f)(3). Consequently, we find these revenue rulings inapposite.

The Commissioner also argues that because there is a real potential for abuse when a transfer of property is made, such a transfer should be prohibited. The potential for abuse is already restrained by Section 4971. Any funding deficiencies caused by the contribution of an overvaluated asset are taxed under Section 4971.

Finally, the Commissioner argues that the tax under Section 4974 is not a penalty tax, and can therefore be construed broadly.[3] We do not decide whether the

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ion, found that the contribution of unencumbered property by an employer to a pension plan was a sale or exchange under Section 406 of ERISA. DOL Advisory Opinion 81-69A (July 28, 1981).

[3] The Commissioner cites *Latterman v. U.S.*, 872 F.2d 564, 568-570 (3d Cir. 1989), in which the court found that the tax imposed by Section 4975 is not a penalty. Keystone argues that this court found that the two tier tax imposed under Section 4941, the statute upon which Section 4975 was modeled, is a penalty tax. *In re Unified Control Systems, Inc.*, 586 F.2d 1036 (5th Cir.1978).

tax imposed by Section 4975 is a penalty tax. Even assuming that it is not a penalty tax and that, therefore, Section 4975 can be construed broadly, a sale or exchange under Section 4975 cannot be construed to include transfers of unencumbered property.

VI

In conclusion, because the plain language of the statute does not include the transfer of unencumbered property to a pension plan as a sale or exchange, and because the Commissioner's arguments that additional words should be read into the statute are unconvincing, we hold that the transfer in this case was not a sale or exchange for purposes of Section 4975(c)(1)(A). The order of the tax court is therefore

AFFIRMED.

APPENDIX B

UNITED STATES TAX COURT

T.C. Memo. 1990-628

KEYSTONE CONSOLIDATED INDUSTRIES, INC.,
PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 4657-89. Filed December 13, 1990.

MEMORANDUM FINDINGS OF FACT AND OPINION

HAMBLEN, *Judge*: Respondent issued a notice of deficiency to petitioner for excise taxes for fiscal years (ending June 30) 1983, 1984, 1985, 1986, 1987, and 1988. The notice of deficiency determined that two transfers of property by petitioner to its employee's pension plan, in satisfaction of petitioner's funding obligations, were prohibited transactions under section 4975.[1] Petitioner timely filed its petition contesting the deficiency. This matter now comes

[1] Unless otherwise indicated, all section references are to the Internal Revenue Code of 1954, as amended and in effect for the years in issue and all Rule references are to the Tax Court Rules of Practice and Procedure.

before the Court on petitioner's motion for summary judgment. Respondent has submitted a cross-motion for summary judgment in his favor. The sole issue for determination is whether petitioner's transfer of unencumbered property to a pension plan, established for the benefit of petitioner's employees, in satisfaction of petitioner's minimum funding obligations, constitutes a sale or exchange within the meaning of section 4975.

FINDINGS OF FACT

The following facts have been stipulated to by the parties. The attached exhibits are incorporated herein by this reference.

Keystone Consolidated Industries, Inc., (hereinafter petitioner) is incorporated under the laws of the State of Delaware. Petitioner's principal office is in Dallas, Texas.

During the taxable years ending June 30, 1983 through June 30, 1988, petitioner maintained several tax-qualified defined benefit plans. Petitioner funded these plans through contributions to the Keystone Consolidated Master Pension Trust (hereinafter the Trust).

On March 8, 1983, petitioner contributed to the Trust five truck terminals (hereinafter the truck terminals) having a fair market value of $9,655,454. Petitioner credited the fair market value of the truck terminals against its minimum funding obligations of the employees' defined benefit plans for the taxable years ending June 30, 1982 and 1983.

On March 13, 1984, petitioner contributed to the Trust real property (hereinafter the Key West property) having a fair market value of $5,336,751. Petitioner credited the fair market value of the Key West

property against its minimum funding obligations of the employees' defined benefit plans for the taxable year ending June 30, 1984.

The truck terminals and Key West property transferred from petitioner to the trust were not encumbered or subject to any mortgage at the time of the transfer. Further, the truck terminals and the Key West property were never leased back to petitioner or any "affiliate" of petitioner.

Petitioner reported these transactions on its income tax returns, taking a deduction in the amount of the fair market value of the property transferred as a contribution to the plan under section 412, and recognizing the difference between the cost of such property and its fair market value as taxable capital gain.

On December 14, 1988, respondent issued a notice of deficiency for excise taxes against petitioner for the fiscal taxable years ending June 30 for 1983, 1984, 1985, 1986, 1987, and 1988. Respondent determined excise taxes owing in the amount of $749,610 for the fiscal year ending June 30, 1984 and $482,773 for each of the other taxable fiscal years at issue. Further, respondent determined an additional excise tax owing for the taxable fiscal year ending June 30, 1988 in the amount of $9,655,454. Petitioner timely filed a petition contesting the determined deficiencies on March 9, 1989.

OPINION

Both respondent and petitioner agree that there are no genuine issues of material fact before the Court in this case. Therefore, judgment on the substantive issue as a matter of law is appropriate. Rule 121(b). See *Espinoza v. Commissioner*, 78 T.C. 412, 416 (1982); *Jacklin v. Commissioner*, 79 T.C. 340, 344 (1982).

Respondent's contention for the determined deficiencies is that property transferred by petitioner to its employees' pension plan in satisfaction of petitioner's funding obligations constitutes a prohibited transaction under section 4975. Respondent does not contest the value set forth by petitioner of the truck terminals or of the Key West property. Therefore, the sole issue before us is whether the transfer of unencumbered property by an employer to a defined benefit plan, maintained for the benefit of its employees, in satisfaction of the employer's minimum funding requirements, is a prohibited transaction when the employer does not retain, directly or indirectly, any control over the transferred property.

Section 4975(a) imposes on "prohibited transactions" an annual five percent tax on the amount involved for each "prohibited transaction" (the "first-tier" tax). The tax imposed is to be paid by any "disqualified person" who participates in the prohibited transaction. Additionally, section 4975(b) imposes a 100 percent tax on any "prohibited transaction" not corrected within the statutory period (the "second-tier" tax). Section 4975(c)(1)(A) defines "prohibited transaction," in part, as any "sale or exchange," or leasing, of any property between a "plan" and a "disqualified person." Section 4975(e)(2)(C) defines a "disqualified person," in part, as an employer, any of whose employees are covered by the "plan." Section 4975(e)(1) sets forth that a trust forming a part of a plan constitutes a "plan" for purposes of section 4975. Therefore, for our purposes, the tax imposed by section 4975(a) must be paid by any employer who enters into a sale or exchange, or lease, with any plan that covers some of the employer's employees.

Petitioner acknowledges that it is a disqualified person with respect to the Trust. Petitioner further acknowledges that the Trust qualifies as a plan under section 4975. Consequently, we must determine only whether the transfers are sales or exchanges pursuant to section 4975(c)(1)(A), and, as such, prohibited.

Respondent argues that petitioner's transfer of unencumbered property to the Trust in satisfaction of its minimum funding obligations constitutes a sale or exchange for purposes of section 4975. Respondent further asserts that this Court should broadly construe the term "sale or exchange" in order to prevent potential abuse. While we agree with respondent that there is a potential for abuse by allowing unencumbered property transfers to plans in satisfaction of minimum funding requirements, we do not agree that the transfer in this case constitutes a sale or exchange under section 4975.

First, respondent attempts to analogize the property transfer to the recognition of income for income tax purposes. Respondent cites authority relating to the recognition of gain on the transfer for income tax purposes and makes the analogy that the same treatment should be afforded in the area of contributions to pension plans. However, the issue of whether a transfer to a pension plan is a prohibited transaction under section 4975 is separate and distinct from income tax recognition. Further, detailed definitions of a sale or exchange for purposes of the prohibited transaction rules should be applied in lieu of general definitions found in other areas of the tax law. See, e.g., *Essenfeld v. Commissioner*, 37 T.C. 117, 122-123 (1961) (quoting *United States v. Chase*, 135 U.S.

255, 260 (1890)), affd. 311 F.2d 208 (2d Cir. 1962). Since section 4975(f)(3) specifically describes certain transfers of real or personal property to a plan by a disqualified person as a sale or exchange for purposes of section 4975, the definitional concerns of "sale or exchange" are removed from the general definitions found in other areas of the tax law. See *Energy Resources Ltd. v. Commissioner*, 91 T.C. 913, 916-917 (1988). Therefore, we do not find respondent's analogy appropriate or persuasive.

Second, respondent contends that employers could transfer "bad" or "illiquid" investments to the plan, thereby hurting the plan's rate of return and investment policies. However, it is the fair market value of the asset at the time of the transfer that controls for valuation purposes. "Bad" or "illiquid" assets would, at least in some part, be reflected by a lower fair market value. Further, respondent has ample opportunity to contest the value of the asset at the time of transfer. Respondent makes no such contention in the present case. Once the asset is transferred, the trustee of the plan must make its independent judgment as to how to treat the asset. If the asset is truly a poor investment, the trustee, acting under its fiduciary capacity, can dispose of it.

We do find merit in respondent's argument that the employer can save costs related to the sale of the asset by transferring it into a plan, rather than selling it outright. However, this potential for abuse is better addressed by Congress. If Congress intended to prevent unencumbered property from being transferred into a plan in satisfaction of the employer's minimum funding requirements, it would have included unencumbered property in section 4975

(f)(3).[2] Respondent's contention that Congress intended transfers of unencumbered property to be prohibited transactions is inconsistent with section 4975(f)(3) which specifies only transfers of encumbered property as a prohibited transaction. In construing the terms of section 4975 "* * * in harmony with the legislative purpose" as respondent suggests (citing *Gruver v. Commissioner*, 142 F.2d 363, 366 (4th Cir. 1944)), it is clear that the Code, and the legislative intent behind it, does not support respondent's determination that petitioner's transfer of unencumbered property to its plan in satisfaction of its funding obligation is a prohibited transaction.

Next, respondent argues that Congress intended to allow unencumbered property to be transferred to a plan only when the transfer was voluntary (i.e., not in satisfaction of the minimum funding requirements of section 412). Respondent further argues that the Code should be read to limit all transfers of property, including unencumbered property, if it satisfies any of the employer's minimum funding obligations. We do not agree. Nothing in section 4975, or related sections, even hints that Congress made a distinction between voluntary and mandatory contributions as they relate to transfers of unencumbered property. To the contrary, Congress made distinctions relating to transfers of property based on other factors.[3] Further, we draw attention to our

[2] Section 4975(f)(3) treats the transfers of encumbered real or personal property by a disqualified person to a plan as a sale or exchange, and thus a prohibited transaction, if the plan assumes the encumbrance or if the encumbrance was placed upon the property by the disqualified person within the last ten years.

[3] See discussion concerning section 4975(f)(3) *infra*.

recent holding, directly on point, where we found that "Nothing in the provisions * * * persuades us that an unexpressed distinction between voluntary and required contributions should be read into the provisions dealing specifically with qualified pension plans." *Wood v. Commissioner*, 95 T.C. —— (Sept. 27, 1990) (slip op. at 10).

We have reviewed respondent's other arguments and find them wholly unpersuasive and without merit. We find no persuasive indication that section 4975 was intended by Congress to make a distinction between voluntary and required contributions to pension plans. Further, we find no credible support to suggest that section 4975, or Congress's intent in drafting it, was intended to restrict the transfer of unencumbered property to a plan in satisfaction of an employer's minimum funding requirements.

For the foregoing reasons,

An appropriate order will be issued.

APPENDIX C

UNITED STATES COURT OF APPEALS
FOR THE FOURTH CIRCUIT

No. 91-1717

DALLAS C. WOOD, PETITIONER-APPELLEE

v.

COMMISSIONER OF INTERNAL REVENUE,
RESPONDENT-APPELLANT

Appeal from the United States Tax Court
(Tax Ct. No. 89-322)

Argued: October 1, 1991

Decided: January 31, 1992

Before WIDENER and NIEMEYER, Circuit Judges, and MERHIGE, Senior United States District Judge for the Eastern District of Virginia, sitting by designation

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OPINION

NIEMEYER, Circuit Judge:

Section 4975 of the Internal Revenue Code imposes an excise tax on any "disqualified person" who participates in a "prohibited transaction" with a qualified defined benefit plan created under ERISA. We are presented with the question of whether the assignment of third-party promissory notes by a disqualified person to a plan in discharge of a funding obligation is a prohibited transaction. The Tax Court determined that it was not. The Commissioner of Internal Revenue appeals, viewing the transaction as a "sale or exchange" of property that is prohibited by 26 U.S.C. § 4975(c)(1)(A) (1988). We agree and therefore reverse.

I

During the years in issue, Dallas Wood was a self-employed real estate broker in Fairfax County, Virginia. As permitted by ERISA, Wood adopted the Dallas C. Wood Defined Benefit Plan ("the plan"), effective January 1, 1984. While Wood is the plan's sole participant and serves as plan administrator and trustee, he relied on an actuary to establish, fund, and operate the plan. The plan, which is subject to the ERISA minimum funding requirements of 26 U.S.C. § 412, permits the receipt of non-cash contributions in satisfaction of its funding requirements. As calculated by the actuary, applying an "aggregate level cost method," the cost of funding the plan for the year which ended December 31, 1984 was $114,000.

In order to meet this funding obligation, Wood contributed three promissory notes with face values totalling $114,000. One note in the face amount of

$60,000 made payable to Wood was received by him in 1983 when he sold his principal residence. The remaining two notes, in the face amounts of $39,000 and $15,000, were executed by purchasers in real estate transactions in which Wood acted as a broker. He purchased these notes at a discount for $32,000 and $11,250, respectively. The notes were transferred to the plan "without recourse" in 1984 and 1985, and by 1986 they all were paid in full.

On his 1984 Federal income tax return, Wood claimed a deduction of $114,000, representing the combined face amount of the notes he contributed to the plan, although the total fair market value of the notes at the time they were transferred to the plan was only $94,430. Wood did not report any gain as a result of this transfer. The parties have now stipulated, however, that the contribution of the notes was a recognition event for income tax purposes and have agreed that Wood was, and is, required to report as capital gains the difference between the face value of the notes and his basis in the notes.

In 1988 the IRS issued a notice of deficiency, having determined that Wood was liable for excise taxes under 26 U.S.C. § 4975(a) in the amount of $3,000 for 1984, $5,700 for 1985, and $5,700 for 1986, representing five percent of the third-party notes contributed as of each of those years. The IRS also imposed penalties for failure to pay the taxes timely.

Wood challenged the determinations of the IRS by filing a petition with the Tax Court for redetermination of the deficiency. The Tax Court agreed with Wood and held that Wood's contribution of third-party promissory notes to the plan was not a prohibited transaction within the meaning of § 4975(c) and that therefore he was not liable for excise taxes. It

reasoned that there is nothing in the Code which precludes the *contribution* of non-cash property to fund a pension trust. As the Tax Court stated:

> In summary, we conclude that nothing in ERISA changes prior law permitting transfers of property to a pension trust. We believe that, if such a change had been intended, Congress would have said so directly rather than by the imposition of a tax under section 4975.

This appeal followed.

II

The Employee Retirement Income Security Act of 1974 (ERISA) was enacted in response to the enormous growth and development of private pension systems, and reflects the congressional concern that certain safeguards be imposed to provide adequate retirement security for plan participants and their beneficiaries. *See* Pub. L. No. 93-406, 88 Stat. 829, 832-33 (1974). It is a comprehensive remedial scheme designed to protect the pensions and benefits of employees by addressing not only the "malfeasance and maladministration in the plans, or the consequences of lack of adequate vesting, but also . . . the broad spectrum of questions such as adequacy of [plan] funding" to pay promised benefits. H.R. Rep. No. 533, 93d Cong., 1st Sess. 9-10 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4639, 4647-4648.

As part of Title II of ERISA, which is administered by the Internal Revenue Service, Congress enacted a prohibited transactions rule to prevent persons with a close relationship to a plan from using that relationship to the detriment of plan beneficiaries. Section 4975 of the Internal Revenue Code imposes two levels of excise tax on "any disqualified

person who participates in [a] prohibited transaction." 26 U.S.C. § 4975(a), (b). It expressly prohibits the direct or indirect:

> (A) sale or exchange, or leasing of any property between a plan and a disqualified person;
>
> (B) lending of money or other extension of credit between a plan and a disqualified person;
>
> (C) furnishing of goods, services, or facilities between a plan and a disqualified person;
>
> (D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;
>
> (E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or
>
> (F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

26 U.S.C. § 4975(c). There is no dispute in this case that Wood is a disqualified person. *See* 26 U.S.C. § 4975(e)(2). The primary point of contention is whether Wood's contribution of third-party promissory notes to the plan is a sale or exchange of property, and thus a prohibited transaction within the meaning of § 4975(c).

The Commissioner contends that the taxpayer's contribution of third-party promissory notes in satisfaction of the statutory funding obligation is a sale or exchange within the meaning of § 4975(c). He argues that the term "sale or exchange" should be given the same meaning as it is given throughout the Tax Code,

including the common notion that a transfer of property in satisfaction of indebtedness constitutes a "sale or exchange" of property. *See, e.g., Rogers v. Commissioner*, 103 F.2d 790, 792-93 (9th Cir.), *cert. denied*, 308 U.S. 580 (1939). Furthermore, the Commissioner argues that transferring property to the plan in satisfaction of an obligation to fund the plan is no different from satisfying the obligation with cash and then causing the plan to use the cash to purchase the property. The Commissioner observes that this interpretation is consistent with the legislative history and the interpretation given to 29 U.S.C. § 1106, a parallel provision in the portion of ERISA administered by the Department of Labor.

Wood acknowledges that § 4975 prohibits sales and exchanges between him and the plan in some circumstances. He readily agrees that if he had funded the plan with cash and then caused the plan to use the cash to purchase the third-party promissory notes from himself, the transaction would be prohibited by § 4975(c). He contends, however, that the prohibition applies only to the *operation and management* of a defined benefit plan, and does not pertain to *contributions* of property to fund the plan. He argues that under the structure of the Tax Code, §§ 4971, 4972, 4973 and 4979 address "the contribution phase" of a plan, imposing taxes for insufficient or improper contributions. Sections 4974 and 4975 (involved here) regulate the "operational phase," imposing taxes on improper management or improper transactions during the course of operations. And finally, he notes that §§ 4976 through 4980B, with the exception of § 4979, govern the "distribution phase" of a plan. In further support of his structural argument that § 4975 does not apply to contributions, Wood points out that

§ 4975 nowhere uses the word "contribution." If Congress intended the section to apply to non-cash contributions, he asserts, it would have said so as it did in sections specifically applicable to the contribution phase.

Alternatively Wood argues that his contribution of third-party promissory notes did not constitute a sale or exchange because § 4975(f)(3) limits the definition of "sale or exchange" to transfers of *encumbered* property. He observes that the Commissioner's interpretation would prohibit funding any plan with stocks, bonds, or any readily salable assets, regardless of their safety, a result that Wood suggests is irrational. Finally, Wood contends that § 4975 must be interpreted in a manner consistent with 26 U.S.C. § 404, which permits him to claim income tax deductions for non-cash contributions to his employee benefit plan.

It was clearly the intent of Congress to prohibit categorically disqualified persons from entering into specified transactions with the plans they sponsor, as such dealings are susceptible to abuse and put in jeopardy the plan's ability to pay promised benefits. Prior to the enactment of § 4975, prohibited transactions rules relied on an "arm's-length" standard of conduct, which "require[d] substantial enforcement efforts, resulting in sporadic and uncertain effectiveness of these provisions." S. Rep. No. 383, 93d Cong., 1st Sess. 32 (1974), *reprinted in* 1974 U.S.C.C.A.N. 4890, 4917. In specifying several categories of transactions that would be subject to the excise tax, Congress intended to displace the "arm's-length" standard with a per se rule which would "substantially strengthen" the laws governing prohibited transactions. *Id.* The purpose of designating sales and ex-

changes of property between insiders and pension plans as prohibited transactions was to ensure pension plan integrity by eliminating even the possibility that such sales or exchanges might not be at arm's length. *See Donovan v. Cunningham*, 716 F.2d 1455, 1464-65 (5th Cir. 1983) (interpreting 29 U.S.C. § 1106, a parallel prohibited-transaction provision in Title I of ERISA), *cert. denied*, 467 U.S. 1251 (1984). Thus, the prohibition against sales or exchanges of property between a plan and a disqualified person is intended to avoid the potential for overvaluations of property to the detriment of the plan, precisely as occurred in this case when Wood purported to discharge a $114,000 obligation with third-party promissory notes having a value of only $94,430. The implementation of this purpose would suggest that all sales or exchanges with the plan by disqualified persons should be prohibited, whether as a contribution or during the operation of the plan.

Wood's structural argument, that the excise tax provisions are organized according to certain phases in a plan's existence and that § 4975 applies only to transactions occurring during the so-called "operational phase," finds little support in the Code. Wood labels §§ 4971, 4972, 4973, and 4979 as sections which apply only to a plan's "contribution phase." While §§ 4971 through 4973 follow in sequence and might otherwise tend to suggest an organizational theme, § 4979 is located in the middle of what Wood labels the "distribution phase" provisions. Furthermore, the applicability of § 4971 is not limited to plan contributions. Section 4971 imposes an excise tax when there is an "accumulated funding deficiency," the existence of which is determined on the basis of the *cumulative* charges and credits to the funding stand-

ard account "for all plan years." 26 U.S.C. §§ 4971 (c)(1), 412(a).

The excise tax sections applicable to pension plans are not structured in accordance with a plan's developmental phases. Rather, the provisions prohibit specific transactions, events, and circumstances that pose a significant threat to the integrity of pension plans and discourage certain benefits that were not of the type Congress favored. Section 4975(c) does not mention the words "contribution," "operation," or "distribution," but instead prohibits without qualification "*any* direct or indirect . . . sale or exchange . . . of any property between a plan and a disqualified person." 26 U.S.C. § 4975(c)(1) (emphasis added). Its blanket prohibition regulates transactions which occur between a plan and a disqualified person because of the potential for abuse inherent in that close relationship. It is immaterial whether the transaction involves a contribution, a distribution, or something in between. In fact, Treasury Regulation § 1.415-6 (b)(4) (1981) (amended in 1991 in respects not material here) addresses the applicability of § 4975 to contributions, and provides:

> *Contributions other than cash.* For the purposes of this paragraph, a contribution by the employer or employee of property other than cash will be considered to be a contribution in an amount equal to the fair market value . . . of the property on the date the contribution is made. *The contribution described in this subparagraph may, however, constitute a prohibited transaction within the meaning of section 4975(c)(1).*

(emphasis added). We therefore conclude that any sale or exchange of non-cash property between a plan

and a disqualified person is a prohibited transaction, whether undertaken for the purpose of making a contribution or otherwise.

Wood contends alternatively that even if § 4975 applies to contributions, his contribution of third-party notes in discharge of his obligation to fund the plan did not constitute a "sale or exchange" as that term is used in § 4975. He argues that § 4975(f)(3) defines only transfers of property encumbered by mortgages or liens as "sales or exchanges" under § 4975 and that therefore the transfer of *unencumbered* property (as is involved here) is not subject to the § 4975 prohibition. The recent Fifth Circuit decision in *Keystone Consol. Indus., Inc. v. Commissioner*, No. 91-4208, 1992 WL 168 (5th Cir. 1992), supports this position.

Section 4975(f)(3) states:

> Sale or exchange; encumbered property.—A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

We do not view § 4975(f)(3) as a special rule limiting the applicability of the excise tax to contributions of encumbered property. On the contrary, its inclusion reveals the intent of Congress to expand the definition of "sale or exchange" as generally understood to include *all transfers* to a plan of *encumbered* property, whether or not in discharge of a debt, because transfers of encumbered property present a

particularly significant potential for abuse. The expansive meaning of § 4975(f)(3) is revealed by the general use of "sale or exchange" under the Internal Revenue Code and the application of the principle that "the Code must be given 'as great an internal symmetry and consistency as its words permit.'" *Commissioner v. Lester*, 366 U.S. 299, 304 (1961) (*quoting United States v. Olympic Radio & Television, Inc.*, 349 U.S. 232, 236 (1955)). Moreover, "[t]he normal rule of statutory construction assumes that 'identical words used in different parts of the same act are intended to have the same meaning.'" *Sorenson v. Secretary of the Treasury*, 475 U.S. 851, 860 (1986) (citations omitted). Because we find that § 4975 (f)(3) serves the special need of expanding the scope of prohibition when *encumbered* property is involved, we find ourselves in disagreement with the reasoning of the Fifth Circuit's decision in *Keystone Consol. Indus.*

The general treatment of the transfer of property in satisfaction of indebtedness as a sale or exchange for tax purposes is long-standing. *See Rogers*, 103 F.2d at 792-93; *Pender v. Commissioner*, 110 F.2d 477, 478 (4th Cir.), *cert. denied*, 310 U.S. 650 (1940). Although the term appears primarily in the income tax chapter, *see, e.g.*, 26 U.S.C. §§ 62, 64, 65, we are aware of no instance when the term "sale or exchange" has been used or interpreted not to include transfers of property in satisfaction of indebtedness.

We note also that the IRS has applied the generally accepted definition to the "sale or exchange" language of § 4975 and has construed the transfer of property in satisfaction of a sponsor's statutory funding obligation as a sale or exchange. *See* Rev. Rul. 80-140, 1980-1 C.B. 89. It is well-established that considerable weight is to be given to an agency's construction of a statute that it is charged with administering. *See Udall v. Tallman*, 380 U.S. 1, 16 (1965); *see also Rose v. Long Island RR Pension Plan*, 828 F.2d 910, 918 (2d Cir. 1987) ("Because the IRS is one of the agencies charged with administering ERISA, its interpretations of the statute are entitled to great deference."), *cert. denied*, 485 U.S. 936 (1988).

Finally, we are persuaded by the interpretation given to a parallel ERISA provision by the Department of Labor, which is responsible for administering Title I of ERISA. The Labor Department has interpreted 29 U.S.C. § 1106, which also prohibits a plan fiduciary from engaging in a transaction that he knows or should know constitutes a direct or indirect sale or exchange of property between the party and a party in interest, to preclude the transfer of non-cash property in satisfaction of a sponsor's funding obligation. *See* Dept. of Labor Op. 81-69A (July 28, 1981); Dept. of Labor Op. 90-05A (March 29, 1990). We find it particularly noteworthy that the legislative history of § 4975 indicates that Congress intended that the prohibited transaction rules in the labor and tax titles apply in a similar manner to like transactions. *See* H.R. Conf. Rep. No. 1280, 93d Cong., 2d Sess. 295-96 (1974), *reprinted in* 1974 U.S.C.C.A.N. 5038, 5076.

Accordingly we conclude that it is appropriate to apply the generally recognized definition of "sale or exchange" to § 4975, and, in so doing, we reject Wood's contention that § 4975(f)(3) limits this definition to transfers of encumbered property. While the transfer to a plan of unencumbered property becomes a sale or exchange only if the transfer satisfies a funding obligation, when encumbered property is in-

volved *all* transfers to the plan are prohibited, regardless of whether they are contributed in satisfaction of a pre-existing debt.

As a final matter, Wood argues that the imposition of an excise tax on the contribution of property in satisfaction of indebtedness is inconsistent with 26 U.S.C. § 404 of the Code, which permits plan sponsors to claim income tax deductions for their non-cash contributions to employee benefit plans. *See Colorado Nat'l Bank v. Commissioner*, 30 T.C. 933 (1958) (holding that contributions of real property to a pension trust fund are deductible under § 404), *acq. in result*, 1959-1 C.B. 3. He alleges that because Congress permits deductions for contributions of property under § 404, it is inconceivable that it intended to impose an excise tax on these same transactions under § 4975.

The Internal Revenue Code permits deductions from gross income for ordinary and necessary business expenses paid or incurred during the taxable year, including a reasonable allowance for salaries or other compensation for personal services actually rendered. 26 U.S.C. § 162. In the absence of § 404, employee pension plan contributions would constitute business expenses deductible under § 162. Section 404, however, displaces the more general provisions of § 162 and allows deductibility, within defined limits, of plan contributions provided the contributions are otherwise deductible. *See* 26 U.S.C. § 404(a). Although the excise tax of § 4975 discourages the contribution of non-cash property in satisfaction of a sponsor's funding obligation, it does not preclude the deductibility of these contributions under § 404 because a reasonable plan contribution, in whatever form, is a business expense and remains deductible as such.

The prohibited transaction provisions of § 4975 are part of a remedial scheme designed to protect the retirement security of plan participants and beneficiaries by prohibiting certain types of transactions which are particularly subject to abuse. We are therefore hesitant to construe these protective provisions narrowly. *See Leigh v. Engle*, 727 F.2d 113, 126 (7th Cir. 1984) (reading broadly the protective provisions of 29 U.S.C. § 1106 "in light of Congress' concern with the welfare of plan beneficiaries"). In addition, the very language of the section indicates that the term "sale or exchange" should not be interpreted restrictively because it applies to both direct and indirect transactions. *See* 26 U.S.C. § 4975(c).

Thus we conclude that when Wood, a concededly disqualified person, transferred non-cash property to the plan to satisfy his statutory funding obligation, he engaged in a "sale or exchange" under § 4975 and therefore is liable for excise taxes. The decision of the Tax Court dated November 16, 1990, is therefore

REVERSED.

APPENDIX D

UNITED STATES TAX COURT

DALLAS C. WOOD, PETITIONER

v.

COMMISSIONER OF INTERNAL REVENUE, RESPONDENT

Docket No. 322-89. Filed September 27, 1990.

COHEN, *Judge:* Respondent determined that petitioner is liable for excise taxes under section 4975(a) in the amount of $3,000 for 1984, $5,700 for 1985, and $5,700 for 1986. Respondent also determined that petitioner is liable for additions to tax under section 6651(a)(1) for failure to file excise tax returns, but respondent has now conceded the additions to tax.

The issue for decision is whether contribution of property to a defined benefit pension plan in order to satisfy the employer's funding obligation is a prohibited transaction, i.e., a "sale or exchange," within the meaning of section 4975(c)(1)(A).

Unless otherwise indicated, all section references are to the Internal Revenue Code as amended and in effect for the years in issue.

FINDINGS OF FACT

The material facts have been stipulated, and the stipulated facts are incorporated in our findings by this reference. Petitioner resided in Alexandria, Virginia, when he filed his petition in this case. During the years in issue, petitioner was a self-employed real estate broker.

In 1983, petitioner sold his principal residence. The buyers of the residence executed a deed of trust note in favor of petitioner for $60,000.

During 1984, petitioner was the real estate broker for the sale of two residential properties. The purchase agreement for each property provided, in part, that the purchasers would execute second trust deed notes in favor of the sellers. Petitioner subsequently purchased these notes, paying $32,000 for a note with a face value of $39,000 and $11,250 for a note with a face value of $15,000.

On October 16, 1984, petitioner adopted the Dallas C. Wood Defined Benefit Plan (the plan), effective January 1, 1984. Petitioner was the sole participant in the plan and served as the plan administrator and as the trustee.

The funding requirements of the plan were set forth in Article XIII as follows:

> *13.01* Benefits provided by this Plan and Trust shall be funded in accordance with the provisions of the Employee Retirement Income Security Act of 1974. The determination of contributions, shall be calculated using an accepted actuarial method. The calculations shall be performed by the actuary selected and approved by the Employer. The actuarial method utilized in funding this Plan and Trust shall be as provided and defined under

the Employee Retirement Income Security Act of 1974.

13.02 A funding standard account shall be maintained for this Plan and Trust. Each Plan Year the funding standard account shall be debited with the amount determined under Section 13.01 of this Plan and Trust and credited with the applicable contribution made for such Plan Year. The funding standard account will be credited or debited with such other amounts as may result from Plan and Trust changes, actuarial assumption changes, actuarial gains and losses, any approved deficiencies as provided under the Employee Retirement Income Security Act of 1974. If the debits under the funding standard account exceed the credits, a deficiency will exist. Such deficiencies will be subject to the provisions of the Employee Retirement Income Security Act of 1974.

The plan did not require that the plan be funded in cash and specifically allowed investment of trust funds in noncash assets.

Petitioner relied on Sal Corrao of Certified Actuarial Services, Inc., to establish, fund, and operate the plan. The aggregate level cost method was adopted as the valuation method used to calculate the cost of the plan benefits. Applying that method, the actuary calculated a cost of $114,000 as the required contribution for the year ended December 31, 1984.

In order to fund the plan, petitioner contributed the three third-party promissory notes previously acquired by him in the transactions described above. On his 1984 Federal income tax return, petitioner

claimed a deduction of $114,000, the combined face amounts of the three notes, for a contribution to the plan. The total fair market value of the three notes at the times that they were transferred to the plan was $94,430.

The three promisory notes were payable by third-party obligors who were unrelated to petitioner and were not "disqualified persons" within the meaning of section 4975. The principal of each note was paid prior to the date on which the note was due.

OPINION

Section 4975(a) and (b) imposes two levels of excise tax on any "disqualified person" who participates in a "prohibited transaction." There is no dispute in this case that petitioner is a disqualified person. See section 4975(e)(1) and (2). The parties disagree as to whether contributions of third-party promissory notes by petitioner to his Defined Benefit Pension Plan were prohibited transactions. The issue is not dependent on the nature of the promissory notes but may be generalized into the question of whether contribution by a disqualified person of property in satisfaction of the obligation to fund a defined benefit pension plan is a prohibited transaction.

Section 4975(c) defines prohibited transactions as follows:

SEC. 4975(c). PROHIBITED TRANSACTION.—

(1) GENERAL RULE.—For purposes of this section, the term "prohibited transaction" means any direct or indirect—

(A) sale or exchange, or leasing, of any property between a plan and a disqualified person;

(B) lending of money or other extension of credit between a plan and a disqualified person;

(C) furnishing of goods, services, or facilities between a plan and a disqualified person;

(D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;

(E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or

(F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

Section 4975(f) sets forth other definitions and special rules including the following:

(3) SALE OR EXCHANGE; ENCUMBERED PROPERTY.—A transfer of real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

Respondent contends that petitioner's contribution of the notes to the plan should be treated as a sale

or exchange consistent with other areas of the Internal Revenue Code in which transfer of property in satisfaction of an indebtedness, in this case the obligation to fund the plan, is taxed as a sale or exchange. Respondent argues that transfer of property in satisfaction of an obligation to fund is distinguishable from a voluntary contribution. According to respondent, section 4975(f)(3), which appears to define sale or exchange in the context of prohibited transactions, is a special rule applicable to voluntary contributions.

Petitioner contends that the prohibited transaction provisions of section 4975 relate only to operations of a plan and that section 4975 has no application to contributions to a plan. Petitioner argues that other sections of the Code, imposing sanctions for failure to satisfy the minimum funding standards applicable to defined benefit plans, are intended to implement the standards applicable to contributions. Petitioner points out that there is no compelling reason why an employer cannot contribute property in satisfaction of a funding obligation. For the reasons and to the extent discussed below, we agree with petitioner.

In *Colorado National Bank of Denver v. Commissioner*, 30 T.C. 933 (1958), we specifically held that a transfer of land to a pension trust was payment to the trust within the meaning of section 404(a)(1)(C). We stated that "There is no reason why a contribution to a pension trust could not be made in property and still be deductible." 30 T.C. at 935. Respondent has not disputed this statement or argued that any legislation subsequent to our decision in *Colorado National Bank of Denver* changes that rule. Respondent has ignored that case, acknowledging, however, that "there is nothing in the

Code which precludes the deduction of a contribution in-kind (to the extent allowable under I.R.C. sec. 404) even though it may constitute a nonexempt prohibited transaction under sec. 4975." A different rule applies, of course, to contribution of a sponsoring employer's own notes. *Don E. Williams Co. v. Commissioner*, 429 U.S. 569 (1977).

Respondent argues that this case illustrates the potential for harm if transfer of property by an employer in satisfaction of an existing funding obligation is not a prohibited transaction. We agree with respondent that this case demonstrates potential for abuse. Petitioner, without any apparent cause, overstated the value of the property contributed to the plan. He had purchased two of the notes at a discount, and, in his business, he was well aware that the face value of the notes was not the fair market value of the notes. He admitted during his testimony at trial that he had not advised his actuarial consultant that he had purchased the notes at a discount. He failed to make the contribution that he claimed for deduction purposes, and he did not satisfy the funding requirements under the method calculated by his actuarial consultant.

Actual harm to a plan is not determinative of whether a transaction is prohibited within the meaning of section 4975. *Rutland v. Commissioner*, 89 T.C. 1137, 1146 (1987). Potential for abuse may be significant, however, if the legislative history and apparent purpose of a statute indicate that the statute was intended to prevent that specific abuse.

The statutory framework and legislative history of section 4975 indicate an intent to prohibit certain transactions without regard to actual abuse. In *Leib v. Commissioner*, 88 T.C. 1474 (1987), the taxpayer

contended that the section 4975(a) excise tax should not be imposed when a transaction would qualify as a prudent investment if judged under the highest fiduciary standards. Respondent argued that whether the prohibited transaction represented a prudent investment or benefited the plan was irrelevant. We agreed with respondent. We analyzed the express language and framework of the statute and the legislative history and concluded that Congress intended a blanket or unconditional prohibition against certain transactions, i.e., those listed in section 4975(c) and not exempted under section 4975(d).

The reasoning in *Leib*, however, indicates a result contrary to respondent's position in this case. If contributions of property are permitted under section 404, as we have held and respondent acknowledges, it is unlikely that Congress intended a blanket prohibition by taxation under section 4975.

Several applicable principles of statutory construction also suggest that a contribution of property to a defined benefit pension plan should not, per se, be deemed a prohibited transaction under section 4975 (c)(1)(A). First, all parts of a statute must be read together, and each part should be given its full effect. See, e.g., *Woods v. Commissioner*, 91 T.C. 88, 98 (1988). Thus, section 4975 must be read as part of the comprehensive provisions of the Employee Retirement Income Security Act of 1974 (ERISA), Pub. L. 93-406, 88 Stat. 829. The excise tax provisions adopted under ERISA include, among other things, excise taxes on self-dealing by private foundations, section 4941, and the excise tax on failure to meet minimum funding standards set forth in section 4971.

Section 4941(d)(1) lists transactions that constitute "self-dealing" in terms indistinguishable from those prohibited transactions listed in section 4975(c).

Section 4941(d)(2)(A) is comparable to section 4975(f)(3) in specifying that a transfer of property shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien placed on the property by the disqualified person and assumed by the transferee. Respondent affirmatively asserts that sections 4941(d) and 4975(c) should be interpreted in a consistent manner and cites revenue rulings in which the Commissioner has taken the position that a transfer of property to a private foundation in cancellation of an indebtedness was a sale or exchange and an act of self-dealing under section 4941. Implicitly recognizing that contributions of property to a private foundation are not prohibited and are common, respondent argues that contributions in-kind that are purely voluntary are treated differently than contributions that discharge an existing obligation.

We agree that prohibited transactions for purposes of qualified pension plans are comparable to acts of self-dealing in relation to private foundations. Compare our discussion in *Leib v. Commissioner, supra,* with *Gershman Family Foundation v. Commissioner,* 83 T.C. 217, 225 (1984); see H. Conf. Rept. 93-1280, 1974-3 C.B. 415, 467 n.2; cf. *Lambos v. Commissioner,* 88 T.C. 1440, 1451-1452 (1987). Nothing in the provisions dealing with private foundations, however, persuades us that an unexpressed distinction between voluntary and required contributions should be read into the provisions dealing specifically with qualified pension plans.

Respondent also argues that the separate sanction for failure to satisfy funding standards set forth in section 4971 does not preclude application of both sanctions to the same set of circumstances. Citing *D.J. Lee, M.D., Inc. v. Commissioner,* 92 T.C. 291,

294-295 (1989), on appeal (6th Cir., May 3, 1989), respondent asserts that "[section 4971] was intended to deal with entirely different concerns than sec. 4975." That case applied section 4971 to an accumulated funding deficiency. It did not compare or discuss section 4975. In any event, if section 4975 was intended to deal with different concerns than section 4971, concerns about overvaluation of contributed property are not a justification for a blanket prohibition of contributions of property. (Other provisions, such as sections 6653(a) and 6661, apply to excessive deductions). Consideration of other provisions of ERISA, therefore, suggests that the scope of section 4975 should be confined to the plain meaning of its language.

All parts of section 4975 must also be read together and given effect. Petitioner argues that section 4975(f)(3) is rendered unnecessary and thus meaningless by respondent's interpretation that a contribution of property in satisfaction of a funding obligation is a sale or exchange. Respondent argues that the special definition of sale or exchange would still apply, but only to voluntary contributions. Respondent's interpretation would diminish the meaning of section 4975(f)(3) in a way not justified by any language in the statute. There is no indication in any part of ERISA that section 4975(f)(3) applies only to voluntary contributions or transfers and not to transfers in satisfaction of a funding obligation.

Petitioner's argument that section 4975 applies only to operations of a plan, not to contributions, is supported by the language in section 4975(c)(1)(A), (B), and (C), describing transactions *between* a disqualified person and a plan. Similarly, section 4975 (c)(1)(D) refers to transfers by a plan to a dis-

qualified person, and sections 4975(c)(1)(E) and (c)(1)(F) refer to acts by which a disqualified person who is a fiduciary deals with plan assets or receives consideration relating to transactions involving plan assets. All of these described transactions involve an act by a person who is acting on behalf of the plan as well as something done by the disqualified person on his or her own behalf. By their nature, these activities occur subsequent to funding of the plan and with respect to preexisting plan assets.

We cannot agree with petitioner, however, that none of the provisions of section 4975 applies to contributions. Section 4975(f)(3) specifically describes certain *transfers to* a plan by a disqualified person as a sale or exchange for purposes of section 4975. This language would include contributions to a plan.

Thus a second applicable principle of statutory construction is that, when Congress has dealt with a particular classification with specific language, the classification is removed from the application of general language. See *Energy Resources Ltd. v. Commissioner*, 91 T.C. 913, 916-917 (1988). In other words, detailed definitions of sale or exchange for purposes of the prohibited transaction rules should be applied in lieu of general definitions found in other areas of the tax law. See, e.g., *Essenfeld v. Commissioner*, 37 T.C. 117, 122-123 (1961), quoting *United States v. Chase*, 135 U.S. 255, 260 (1890).

The parties have stipulated that petitioner will be required to report, as capital gain, the difference between the face value of the notes and the amount of his purchase price for the notes. (The rationale of this result is unstated and unclear.) Although petitioner's transfer of the notes to the plan is a sale or exchange for purposes of recognition of income to him, it does not necessarily follow that the transfer

is a prohibited transaction under section 4975. With respect to transfers to a plan by a disqualified person, unaccompanied by affirmative acts on behalf of the plan, section 4975(f)(3) provides the definition of sale or exchange.

A third principle of statutory construction, i.e., that penalty provisions must be strictly construed, is also of assistance in interpreting section 4975. See *Commissioner v. Acker*, 361 U.S. 87, 91 (1959). Because its purpose as a blanket prohibition is to deter certain types of conduct, the excise tax imposed under section 4975(a) is in the nature of, and for some purposes is, a penalty provision. See *Nieto v. Ecker*, 845 F.2d 868, 874 n. 6 (9th Cir. 1988); cf. *Matter of Unified Control Systems*, 586 F.2d 1036, 1039 (5th Cir. 1978); compare *Latterman v. United States*, 872 F.2d 564, 568-570 (3d Cir. 1989).

Respondent assumes but does not concede that section 4975(a) imposes a penalty tax. He asserts:

> the issue in this case would still be whether there is "any expressed or necessarily implied provision or language . . ." (*Commissioner v. Acker*, 361 U.S. 87, 91 (1959)) which allows for the treatment of contributions in-kind as a prohibited transaction. And, in respondent's view, the "sale or exchange" language contained in sec. 4975(c)(1)(A) provides the necessary expression of congressional intent in this context. This is especially true in view of the fact that the statutory language itself manifests an intent that sec. 4975(c)(1) be given a broad reading. * * *

We cannot agree that the language of section 4975 provides the necessary expression (1) that contributions of property are subject to different standards than contributions of cash, or (2) that contributions

required under a plan are subject to different standards than voluntary contributions. These distinctions are basic, and the disputed transactions occur frequently enough that, we believe, Congress would have stated the distinctions if they were intended. Compare section 408(a)(1), requiring (with limited exceptions) that contributions to an Individual Retirement Account be in cash. See also section 401(a)(8), providing a special rule for forfeitures under a defined benefit plan. The provisions of ERISA as a whole are unusually detailed and specific. We decline to impose on section 4975(a) refinements that have not been specified by Congress.

We acknowledge that the interpretation given by the U.S. Department of Labor (DOL) to the parallel language in Title I of ERISA, section 406(a), is consistent with respondent's position in this case. See DOL Advisory Opinions 81-69A (July 28, 1981), and 90-05A (Mar. 29, 1990). The DOL has general interpretative authority under both Titles I and II of ERISA; consequently, the DOL's interpretation of the corresponding provisions under Title I is entitled to consideration in construing section 4975(c). In this case, however, we conclude that the language of the statute, interpreted in accordance with the principles stated above, must control. The language does not support the position of DOL or of respondent.

In summary, we conclude that nothing in ERISA changes prior law permitting transfers of property to a pension trust. We believe that, if such a change had been intended, Congress would have said so directly rather than by the imposition of a tax under section 4975.

For the foregoing reasons,

Decision will be entered for the petitioner.

APPENDIX E

INTERNAL REVENUE CODE (26 U.S.C.):

Section 401. Deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred-payment plan

(a) General rule.—If contributions are paid by an employer to or under a stock bonus, pension, profit-sharing, or annuity plan, or if compensation is paid or accrued on account of any employee under a plan deferring the receipt of such compensation, such contributions or compensation shall not be deductible under this chapter; but, if they would otherwise be deductible, they shall be deductible under this section, subject, however, to the following limitations as to the amounts deductible in any year:

* * * * *

(3) Stock bonus and profit-sharing trusts.—

(A) Limits on deductible contributions.—

(i) In general.—In the taxable year when paid, if the contributions are paid into a stock bonus or profit-sharing trust, and if such taxable year ends within or with a taxable year of the trust with respect to which the trust is exempt under section 501(a), in an amount not in excess of 15 percent of the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the stock bonus or profit-sharing plan.

Section 412. Minimum funding standards.

(a) General Rule.—Except as provided in subsection (h), this section applies to a plan if, for any plan year beginning on or after the effective date of this section for such plan—

(1) such plan included a trust which qualified (or was determined by the Secretary to have qualified) under section 401(a), or

(2) such plan satisfied (or was determined by the Secretary to have satisfied) the requirement of section 403(a).

A plan to which this section applies shall have satisfied the minimum funding standard for such plan for a plan year if as of the end of such plan year, the plan does not have an accumulated funding deficiency. For purposes of this section and section 4971, the term "accumulated funding deficiency" means for any plan the excess of the total charges to the funding standard account for all plan years (beginning with the first plan year to which this section applies) over the total credits to such account for such year or, if less, the excess of the total charges to the alternative minimum funding standard account for such plan years over the total credits to such account for such years. In any plan year in which a multiemployer plan is in reorganization, the accumulated funding deficiency of the plan shall be determined under section 428B.

* * * * *

Section 4941. Taxes on self-dealing

(a) Initial Taxes.

(1) On Self-Dealer.—There is hereby imposed a tax on each act of self-dealing between a disqualified person and a private foundation. The rate of tax shall be equal to 5 percent of the amount involved with respect to the act of self-dealing for each year (or part thereof) in the taxable period. The tax imposed by this paragraph shall be paid by any disqualified person (other than a foundation manager acting only as such) who participates in the act of self-dealing. In the case of a government official (as defined in section 4946(c)), a tax shall be imposed by this paragraph only if such disqualified person participates in the act of self-dealing knowing that it is such an act.

* * * * *

(b) Additional taxes.—

(1) On self-dealer.—In any case in which an initial tax is imposed by subsection (a)(1) on an act of self-dealing by a disqualified person with a private foundation and the act is not corrected within the taxable period, there is hereby imposed a tax equal to 200 percent of the amount involved. The tax imposed by this paragraph shall be paid by any disqualified person (other than a foundation manager acting only as such) who participated in the act of self-dealing.

* * * * *

(d) Self-Dealing.—

(1) In General.—For purposes of this section, the term "self-dealing" means any direct or indirect—

(A) sale or exchange, or leasing, of property between a private foundation and a disqualified person;

* * * * *

(2) Special Rules.—For purposes of paragraph (1)—

(A) the transfer of real or personal property by a disqualified person to a private foundation shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the foundation assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer;

* * * * *

Section 4971. Taxes on failure to meet minimum funding standards

(a) Initial tax.—For each taxable year of an employer who maintains a plan to which section 412 applies, there is hereby imposed a tax of 10 percent (5 percent in the case of a multiemployer plan) on the amount of the accumulated funding deficiency under the plan, determined as of the end of the plan year ending with or within such taxable year.

(b) Additional tax.—In any case in which an initial tax is imposed by subsection (a) on an accumulated funding deficiency and such accumulated funding deficiency is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of such accumulated funding deficiency to the extent not corrected.

Section 4975. Tax on prohibited transactions

(a) *Initial Taxes on Disqualified Person.*—There is hereby imposed a tax on each prohibited transaction. The rate of tax shall be equal to 5 percent of the amount involved with respect to the prohibited

transaction for each year (or part thereof) in the taxable period. The tax imposed by this subsection shall be paid by any disqualified person who participates in the prohibited transaction (other than a fiduciary acting only as such).

(b) *Additional Taxes on Disqualified Person.*—In any case in which an initial tax is imposed by subsection (a) on a prohibited transaction and the transaction is not corrected within the taxable period, there is hereby imposed a tax equal to 100 percent of the amount involved. The tax imposed by this subsection shall be paid by any disqualified person who participated in the prohibited transaction (other than a fiduciary acting only as such).

(c) *Prohibited Transaction.*—

* * * * *

(1) *General rule.*—For purposes of this section, the term "prohibited transaction" means any direct or indirect—

(A) sale or exchange, or leasing, of any property between a plan and a disqualified person;

(B) lending of money or other extension of credit between a plan and a disqualified person;

(C) furnishing of goods, services, or facilities between a plan and a disqualified person;

(D) transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a plan;

(E) act by a disqualified person who is a fiduciary whereby he deals with the income or assets of a plan in his own interest or for his own account; or

(F) receipt of any consideration for his own personal account by any disqualified person who is a fiduciary from any party dealing with the plan in connection with a transaction involving the income or assets of the plan.

* * * * *

(e) *Definitions.*—

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(2) *Disqualified person.*—For purposes of this section, the term "disqualified person" means a person who is—

(A) a fiduciary;

(B) a person providing services to the plan; [or]

(C) an employer any of whose employees are covered by the plan; * * *.

* * * * *

(f) *Other Definitions and Special Rules.*—For purposes of this section—

* * * * *

(3) *Sale or Exchange; Encumbered Property.*—A transfer [of] real or personal property by a disqualified person to a plan shall be treated as a sale or exchange if the property is subject to a mortgage or similar lien which the plan assumes or if it is subject to a mortgage or similar lien which a disqualified person placed on the property within the 10-year period ending on the date of the transfer.

Section 302 of ERISA, 29 U.S.C. 1082. Minimum funding standards

(a) Avoidance of accumulated funding deficiency

(1) Every employee pension benefit plan subject to this part shall satisfy the minimum funding standard (or the alternative minimum funding standard under section 1085 of this title) for any plan year to which this part applies. A plan to which this part applies shall have satisfied the minimum funding standard for such plan for a plan year if as of the end of such plan year the plan does not have an accumulated funding deficiency.

(2) For the purposes of this part, the term "accumulated funding deficiency" means for any plan the excess of the total charges to the funding standard account for all plan years (beginning with the first plan year to which this part applies) over the total credits to such account for such years or, if less, the excess of the total charges to the alternative minimum funding standard account for such plan years over the total credits to such account for such years.

* * * * *

Section 406 of ERISA, 29 U.S.C. 1106. Prohibited transactions

(a) Transactions between plan and party in interest

Except as provided in section 1108 of this title:

(1) A fiduciary with respect to a plan shall not cause the plan to engage in a transaction, if he knows or should know that such transaction constitutes a direct or indirect—

(A) sale or exchange, or leasing, of any property between the plan and a party in interest;

(B) lending of money or other extension of credit between the plan and a party in interest;

(C) furnishing of goods, services, or facilities between the plan and a party in interest;

(D) transfer to, or use by or for the benefit of, a party in interest, of any assets of the plan; or

(E) acquisition, on behalf of the plan, of any employer security or employer real property in violation of section 1107(a) of this title.

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